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INTERCO

1979 Annual Report

Fifteen years of uninterrupted growth

INTERCO 68th ANNUAL REPORT

INTERCO TODAY

INTERCO is a broadly based major manufacturer and retailer of popular-priced products and services for the middle-income consumer, represented by three operating groups:

Apparel Manufacturing Group consists of eleven apparel companies operating 61 manufacturing plants and 13 major customer distribution centers across the country. The group designs, manufactures and distributes a full range of branded and private-label sportswear, casual apparel, outer garments and headwear for men and women. Distribution is national in scope to department stores, specialty shops and other retail units. Substantial distribution, under private label, is also made to large national retail and discount chains.

General Retail Merchandising Group operates 821 retail locations in 29 states in this country, offering to the consumer a large assortment of popular-priced products and services. General retailing includes junior department stores, discount stores, men's and women's specialty apparel shops, specialty department stores and large do-it-yourself home-improvement centers. Ten modern regional distribution centers support these retail locations in different regions of the country.

Footwear Manufacturing and Retailing Group operates 844 retail shoe stores and leased shoe departments in 43 states in this country, as well as in Australia, Canada and Mexico. The group also styles, manufactures and distributes, primarily, men's footwear in most major price ranges in the United States, Canada and Australia. There are 24 shoe manufacturing plants and 4 major distribution centers in operation.

The Annual Meeting of Stockholders will be held at 10 a.m., Monday, June 25, 1979, at the Marriott Pavilion Hotel (formerly Breckenridge Pavilion Hotel), One Broadway, St. Louis, Missouri. Notice of the meeting and a proxy statement will be sent to stockholders in a separate mailing.

A copy of INTERCO INCORPORATED's current Form 10-K Annual Report, filed with the Securities and Exchange Commission, can be obtained by writing to: Office of the Treasurer, INTERCO INCORPORATED, Ten Broadway, St. Louis, Missouri 63102.

Highlights

Fiscal Years Ended February 28	1979	1978	Change
From operations:			
Net sales	$1,851,458,000	$1,666,657,000	+ 11.1%
Earnings before income taxes	186,869,000	161,579,000	+ 15.7%
Net earnings	92,576,000	81,834,000	+ 13.1%
Percent of net sales	5.0%	4.9%	
Per share of common stock:			
Earnings	$6.37	$5.70	+ 11.8%
Dividends	$2.10	$1.85	+ 13.5%
Financial condition at year end:			
Working capital	$ 537,878,000	$ 532,361,000	+ 1.0%
Current ratio	3.7 to 1	4.2 to 1	
Total assets	1,003,075,000	899,778,000	+ 11.5%
Stockholders' equity	684,164,000	621,512,000	+ 10.1%
Book value per share of common stock	$47.56	$43.34	+ 9.7%
Return on stockholders' average investment	14.2%	13.8%	
Common shares outstanding at year end	14,386,479	14,341,155	
Number of stockholders	16,000	16,500	
Number of employees	43,000	44,000	

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To Our Stockholders

Fiscal year ended February 28, 1979, was another record year for your company in sales, net earnings and earnings per share — for the fifteenth consecutive year. Sales were $1.85 billion, net earnings were $92.6 million and earnings per share were $6.37.

We are pleased with the operating results for fiscal 1979 as each of our three business groups — Apparel Manufacturing — General Retail Merchandising — Footwear Manufacturing and Retailing — contributed to the improvement and each group had record sales and earnings.

The record results for fiscal 1979 are further evidence of the value of our diversification program, dedication to management disciplines, and our ability to control costs and to improve productivity.

Communication is achieved on a regular basis by monthly meetings at corporate headquarters with the presidents of our operating divisions who serve on the Operating Board of the company. These meetings provide the opportunity for constantly measuring performances, including return on assets employed, inventory turnover, exchange of marketing trends, the sharing of the newest manufacturing and retailing techniques, and the complete involvement and cooperation required to accomplish our budgeted goals.

The financial strength of your company grew even stronger during fiscal 1979. For the first time, our assets exceeded $1 billion, and we enter the new year with an excellent debt-equity leverage, a strong working capital ratio, and cash, including marketable investment securities, of $105.7 million.

Cash dividends on the company's common stock were increased 10% during fiscal 1979 and the current annual rate is $2.20 per share. The company has paid cash dividends on its common stock for sixty-eight years without interruption and has increased cash dividends for the past fourteen consecutive years — from $0.60 to $2.20 per share, or an increase of 267%. Your Board of Directors will continue to make frequent reviews of the dividend rate in relation to the expected growth of the company.

Our program of expansion and diversification continued during fiscal 1979 with the addition of Alberts, a chain of 74 women's specialty shops. This fine retail operation expands your company into a new market with excellent profit and growth opportunities. Careful diversification and expansion through acquisition will continue to be a part of our planned growth program.

At our June, 1978, annual meeting of stockholders, five new and highly qualified directors were elected to the Board of Directors — Zane E. Barnes, President and Chief Executive Officer of Southwestern Bell Telephone Company; Thomas H. O'Leary, President of Missouri Pacific Corporation; Jonathan P. Myers, President of Londontown Corporation; Charles J. Rothschild, Jr., President of Campus Sweater & Sportswear Company; and Harvey Saligman, President of Queen Casuals, Inc. The last three named new directors are presidents of operating divisions of your company.

Also at our June, 1978, stockholders' meeting, three valued members of the Board retired after having made substantial contributions for many years — Philip N. Hirsch, James L. Johnson and Herbert Shainberg.

During fiscal 1979, Gerald B. Hirsch, Jonathan P. Myers, J. Carl Powers, Charles J. Rothschild, Jr., and Harvey Saligman were elected vice-presidents of the company. These five named new officers are presidents of operating divisions of your company. Also, Wilfred G. Morice was elected Assistant Controller.

We enter fiscal 1980 in a very strong financial position with proven management teams and competitive, popular-priced products and services, directed towards the customer needs for quality and value. These strengths offer great opportunities for the long-term future of your company, which we view with confidence.

However, based on current indications and trends, we are concerned that the months ahead will bring many uncertainties. Of major importance will be the effect of rising inflation, consumer attitudes, and severe pressure on profit margins. Our prime objectives will be to examine critically all operations to assure sound employment of our assets, to maintain our aggressive cost control program, and to intensify our realistic profit improvement objectives.

We are budgeting our business for more moderate growth during fiscal 1980 and, therefore, we expect another good year for your company.

We regret that Edward P. Grace, Treasurer of your company and an executive for nearly thirty years, passed away on April 13, 1979. We are grateful for his many contributions to the growth of the company over the years.

I wish to thank our loyal and conscientious employees for their efforts during the past year. We also wish to thank our customers for making it all possible and our shareholders for their continuing support and confidence.

W. L. Edwards Jr.

Chairman of the Board and
Chief Executive Officer

April 14, 1979

William L. Edwards, Jr.

ALBERTS joins INTERCO

Alberts, headquartered in Detroit, Michigan, and operating a chain of 74 women's specialty shops, became a part of the General Retail Merchandising Group on July 12, 1978.

The first *Alberts* store opened in Detroit in 1933. The success of regional shopping centers and enclosed malls enabled *Alberts* to expand into suburban metropolitan areas. Of the 74 shops of *Alberts, Inc.*, 49 are located in Michigan, 13 in Illinois, 6 in Ohio, 3 in Missouri, 2 in Indiana and 1 in Kentucky.

The fashion and value requirements of style-conscious women are met through two distinct groups of *Alberts* retail apparel shops, each with separate merchandising methods and display themes geared to the needs and demands of their particular customers.

- The *Alberts* and *Albert K* shops, ranging from 7,000 to 11,000 square feet, emphasize the traditional look, and carry established nationally advertised brands for the young contemporary woman. The merchandise carried in these stores is suited to meet the demands of the young woman seeking style and value.

- *Alcove* shops feature the boutique format appealing to the fashion-conscious young shopper. The merchandise is designed to meet the demands of the customer whose wardrobe must be "right". The *Alcove* boutiques range from 4,000 to 6,000 square feet.

With women more active in the business and professional worlds, traveling more, and certainly value conscious, the retailer must create a selling environment to which they will respond. *Alberts*' management has proven its ability to meet the challenge and in joining the company offers a strong and aggressive management team.

Alberts provides the company with an excellent growth opportunity in this new retail market.


alberts


ALCOVE
ALCOVE

Apparel Manufacturing Group

During fiscal 1979, the Apparel Manufacturing Group achieved record results in both sales and earnings. The group contributed $731.3 million or 39.5% of the consolidated sales, and $95.6 million or 48.4% of the earnings of the company, providing a return on sales before income taxes, corporate expenses and interest cost of 13.1%. The sales increase amounted to 14.2% and the earnings improved by 10.2%.

The record results were accomplished during a period of some mixed market conditions. It was a year of growth for outerwear, rainwear, coordinated and basic sportswear, separates and casual apparel for men and women; and as a result, these operations continued to show impressive gains in market penetration. It was also a period during which the demand in the retail market for men's basic heavy denim jeans leveled off. As a result, retailers experienced a period of competition which caused substantial promotional activity that affected retail prices and consequently slowed orders at the manufacturing level. The impact of lower sales volume produced less than satisfactory results in the company's jeans manufacturing operations.

Today the Apparel Manufacturing Group consists of eleven companies producing a full range of casual apparel and sportswear which is marketed through leading department stores, specialty shops, and large retail chains across the country. Pictured on pages 7 through 11 is a sampling of the merchandise produced and sold by our company.

Our principal products for men and young men are sport, knit and dress shirts, slacks, jeans, sweaters, sport coats, blazers, casual sport suits, swimwear, walk shorts, outerwear, rainwear, and hats. These products are marketed under private-label and brand names, such as *London Fog* and *Campus* — names synonymous with style and quality.

The company's women's apparel products include suits, dresses, pants, skirts, jackets, sweaters, hats, blouses, shirts, T-shirts, vests, culottes, blazers, rainwear, outerwear and jeans. Women recognize such names as *College-Town, Devon, Pant-her, Queen Casuals, It's Pure Gould, Stuffed Shirt* and *London Fog* when shopping for garments with fashion and value.

Continuing efforts are made to improve productivity through the acquisition of new and more efficient plants and machinery. We added three factories and expanded one in fiscal 1979, while closing four which were smaller and less efficient. Next year we plan to open one additional manufacturing plant and add a total of 400,000 square feet to existing distribution centers to provide for anticipated future growth.

The company, in its program to keep pace with changes in style and demand, introduced several new lines during the year.

- *College-Town* added the *REJOICE!* line for the larger-size contemporary woman. Shipments began in August and, based upon initial reactions, the line has been well received at the retail level. This new line provides the quality and fashion appeal which has been the hallmark of the *College-Town* and *Pant-her* brands.
- Knit shirts and skirts were introduced to the "Pure Gould" customer, providing styles, which are fresh and new, and the ease of care that is sought in today's market.

- Under the *London Fog* label, the *StormShed* line of men's and women's rainwear and outerwear was successfully tested and is being marketed nationally. This line incorporates an improved water repellent fabric that is truly comfortable to wear, and is an exclusive *London Fog* entry that will further enhance its position in the prestige segments of the outerwear market.
- Several of our apparel companies incorporated into their lines the new designer-name jeans for men and women. These products, produced of light-weight fabrics and featuring the fashionable straight-leg styling, have been highly successful.

Aggressive marketing, thoughtful design and distinctive advertising campaigns are integral parts of our sales promotion plan and provide the company with an excellent opportunity to continue to improve its stature in the men's and women's apparel market.

The Apparel Manufacturing Group remains innovative in its selection of the newest fabrics, styles, colors and production methods to provide the consumers with the quality they have come to expect — at an affordable price. As a result, we expect another good performance in fiscal 1980 from this business.


devon
GATEWAY CASUALS
Stuffed Shirt
STUFFED JEANS

Major Apparel Brands for Women and Young Women:

Clipper Mist
College-Town
Devon
Gateway Casuals
It's Pure Gould
Lady Devon
Lady Queen
London Fog
Pant-her
Queen Casuals
REJOICE!
Stuffed Jeans
Stuffed Shirt

Major Apparel Brands for Men and Young Men:

Big Yank
Biltwell
Campus
Clipper Mist
Concept II by Campus
Cowden
Easy Life by Campus
Esprit by Campus
Gateway Casuals
John Alexander
Leonard Macy
London Fog
Mr. Golf
Mr. Tennis
Pro-action by Campus
Rugged Country by Campus
Startown
Studio One by Campus
Tailor's Bench
Tour de France

Tailor's Bench

General Retail Merchandising Group

The General Retail Merchandising Group was expanded this year by the addition of the *Alberts* chain of 74 women's specialty shops and by expansion of continuing operations into new and existing geographical markets. At the close of the fiscal year, the group had 383 junior department stores, 256 self-service, convenience discount stores, 150 men's and women's specialty apparel shops, 24 large do-it-yourself home improvement centers and 8 specialty department stores, for a total of 821 stores.

There were 117 stores added and 28 stores closed or relocated during the year. The plans for fiscal 1980 include the addition of 55 new stores and expansion of existing warehousing facilities.

Record sales of this business were $582.4 million, or 31.5% of consolidated sales, an increase of 11.8% over last year. Record earnings, before income taxes, corporate expenses and interest cost, increased to $40.6 million, or 20.5% of the earnings of the company, for a return on sales of 7.0%. These sales and earnings were the highest in the history of the General Retail Merchandising Group.

- *Central Hardware* provides a complete selection of home improvement and energy-saving products for the do-it-yourselfer. With the energy crisis and adverse winter weather conditions, the installation of insulation, aluminum storm windows and doors, water heaters and roofing has contributed to its record performance.

  New items are continually coming onto the market, many in the energy control area, and *Central* is aggressively seeking out such items, making certain of their quality and value, before offering the product for sale to its customers.

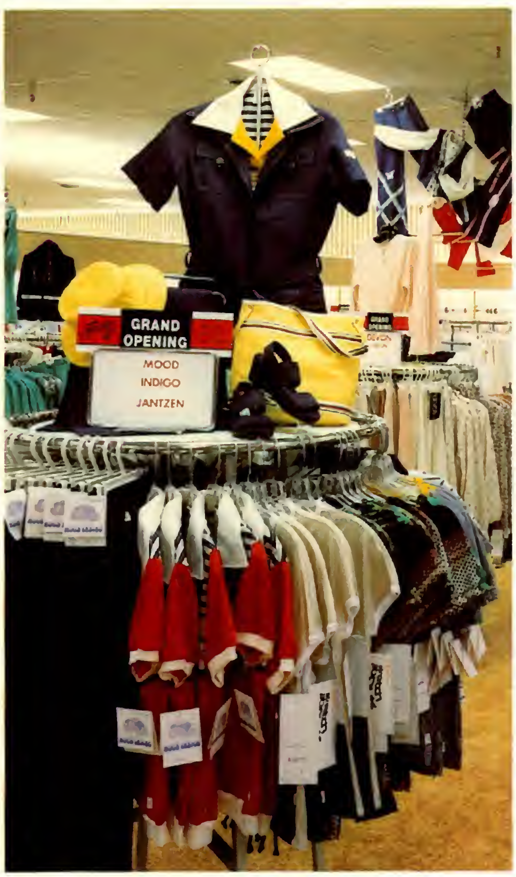
  During the year, *Central Hardware* added three stores in the Cincinnati, Ohio area and in fiscal 1980 will enter another new consumer market — Columbus, Ohio.

  Pictured on page 14 is *Central Hardware's* Third Annual Tinker Show held at the Cervantes Convention Center in St. Louis, Missouri. Suppliers demonstrate products and services, which are available at the *Central* stores. Each year attendance has grown and response to the program has been excellent.
- The company's convenience discount stores, operating as *Sky City Stores* and *Eagle Family Discount Stores*, offer a full range of housewares, sporting goods, small and major appliances, home furnishings, health and beauty aids, jewelry, toys, lawn and garden supplies, automotive accessories and apparel for the family, all at moderate prices. Stores are located throughout the South and Southeast, one of the fastest growing sections of the country.
- Our chain of specialty apparel shops markets a complete line of high-quality fashion apparel and accessories for men in the *Fine's*, *Standard* and *United* stores and for women in the *Alberts*, *Albert K* and *Alcove* stores. The shops are located principally in enclosed-mall shopping centers, and present an uncluttered, open and well-lit decor carried out in decorator colors which set the tone for today's style of shopping. Eleven states are now being served by these stores in the Eastern, Mid-Atlantic and Central regions of the country.

- The junior department stores, operating under the names of *P. N. Hirsch, Hirsch Value Centers, Carithers, Keith O'Brien, Kent's, Miller's, Shainberg's, Thornton's* and *Wigwam* utilize their merchandising capability principally to offer their customers basic clothing and household needs. These stores, located primarily in small and medium-size communities, offer good quality at competitive prices.
- *Golde's,* a chain of specialty department stores, featuring primarily branded merchandise designed to give the consumer fashion and quality, had a record sales year in fiscal 1979.

The General Retail Merchandising Group is dedicated to bringing to its customers outstanding values and services at popular prices, and its strategy will continue to cater to middle-income America in fiscal 1980.

Central Hardware's
Third Annual Tinker Show



Major Retail Trading Names:

Alberts
Albert K
Alcove
Central Hardware
Carithers
Eagle Family Discount Stores
Fine's
Golde's
Hirsch Value Center
Idaho Department Store
Jeans Galore
Keith O'Brien
Kent's
Miller's
P. N. Hirsch
Shainberg's
Sky City Discount Center
Standard Sportswear
Thornton's
United Shirt
Wigwam

Footwear Manufacturing and Retailing Group

The company's Footwear Manufacturing and Retailing Group showed substantial improvement in fiscal 1979, which resulted in record high sales and earnings. Sales were $537.8 million — up 6.5%, or 29.0% of consolidated sales — and earnings before income taxes, corporate expenses and interest cost were $61.5 million, or 31.1% of total earnings, representing an increase of 38.1% and a return on sales of 11.4%, an outstanding performance.

Footwear Manufacturing

The footwear manufacturing business of the company directs its efforts to satisfy consumers' demand for quality footwear — including dress and work shoes, casual footwear and boots — primarily for men. The company also produces footwear for women.

Our game plan is to produce shoes of the highest quality while maintaining their competitive price structure. In this effort, the company has acquired a large number of the most sophisticated stitching machines in the shoe industry. The performance of these machines has been up to expectation and, as expected, reduced costs in some key stitching operations. Continuing our program of quality control, we established a testing laboratory which allows for a more thorough examination and analysis of incoming materials from suppliers to make certain that proper quality is maintained.

In an effort to consolidate more effectively the company's Canadian operations and improve its return on assets, the juvenile and a portion of the women's shoe manufacturing operations in Canada were sold during the year.

- *Florsheim,* a renowned name in the manufacturing of men's shoes, has a product that signifies the highest quality, unquestioned styling and fashion — and markets its shoes under such brand names as *Florsheim, Idlers by Florsheim* and *Weeds from Florsheim.* Always conscious of the high standard it must maintain, *Florsheim* is continually seeking ways to improve its product, but only within the guidelines synonymous with the *Florsheim* name.
- *International Shoe* produces a full range of popular-priced footwear for men and women, both branded and private-label. *Hy-Test,* the outstanding safety shoe, continues to be a top name in industrial and casual safety footwear.

  This year, *Hy-Test* introduced a line of rugged pigskin casuals for men and women designed to meet certain industrial demands for protective safety footwear, yet retain the styling necessary for casual wear.

Footwear Retailing

Footwear retailing had another record year of growth in sales and earnings in fiscal 1979. During the year, we opened fifty-two new locations and at year end we were operating 844 shoe stores and leased shoe departments, a slight decrease from last year because of closing or relocating smaller, marginally profitable units.

- Operations are conducted in 665 *Florsheim Shoe Shops, Florsheim Thayer McNeil Shops* and leased shoe departments in leading clothing and department stores. Expansion will continue in the coming year with the opening of 40 new locations, the objective being to seek prominent locations in prestigious and high-volume regional shopping centers.

• *Senack Shoes, Inc.*, operating a group of 179 leased shoe departments and stores, had a record sales and earnings performance in fiscal 1979. *Senack's* policy to close or relocate smaller, less productive units and replace them with departments that are larger and potentially more profitable was a strong factor contributing to its overall performance gain.

Florsheim's Dealer Development Program, which provides operational and store design consultation to existing and new *Florsheim* dealers, completed 41 openings and major renovation projects during the year.

Pictured on pages 17 through 19 are stores and products carried therein, which are an integral part of the footwear segment of our business.

We concluded the year as a major manufacturer and retailer of quality footwear. Entering the new year we are faced with rapidly increasing leather costs. Continued emphasis will be placed on updating and modernizing plants and equipment employed in the manufacturing process, and the continued expansion into new and existing markets.

Major Retail Trading Names:
Florsheim Shoe Shops
Florsheim Thayer McNeil Shops
Duane's
Miller Taylor
Phelp's
Thayer McNeil Shoes
Thompson, Boland & Lee


HY-TEST.
VITALITY.
FLORSHEIM.

Major Footwear Brands:

For Men:
Ambassador
City Club
Florsheim
Florsheim Imperial
Royal Imperial by Florsheim
Idlers by Florsheim
Weeds from Florsheim
Grizzlies
Hy-Test
Julius Marlow
Patriot
Rand
Roberts
Winthrop
Worthmore

For Women:
Crawdads
diVina
Miss Wonderful
Patriot
Personality
Thayer McNeil
Thomas Wallace
Vitality

Fiscal 1979 in Review

For the fifteenth consecutive year, INTERCO achieved record sales and earnings, and at February 28, 1979, was in the strongest financial position in its history.

Our three operating groups' sales and earnings for a five-year period are presented below, in thousands of dollars. These figures have been restated to include pooled companies, for years prior to their acquisition, and the retroactive restatement of capital leases.

	Fiscal Years Ended				
	1979	1978	1977	1976	1975
Net sales:					
Apparel	$ 731,259	$ 640,487	$ 576,019	$ 484,152	$ 469,171
General Retail	582,441	521,178	498,557	474,230	425,688
Footwear	537,758	504,992	491,856	465,870	478,364
Total	$1,851,458	$1,666,657	$1,566,432	$1,424,252	$1,373,223
Earnings before income taxes:					
Apparel	$ 95,585	$ 86,745	$ 78,050	$ 63,715	$ 53,482
General Retail	40,581	38,096	32,473	35,219	28,534
Footwear	61,520	44,552	48,768	43,884	50,545
	197,686	169,393	159,291	142,818	132,561
Less corporate expenses and interest cost	(10,817)	(7,814)	(9,899)	(7,033)	(11,474)
Total	186,869	161,579	149,392	135,785	121,087
Income taxes	94,293	79,745	73,122	67,212	59,853
Net earnings	$ 92,576	$ 81,834	$ 76,270	$ 68,573	$ 61,234
As a percent of sales	5.0%	4.9%	4.9%	4.8%	4.5%

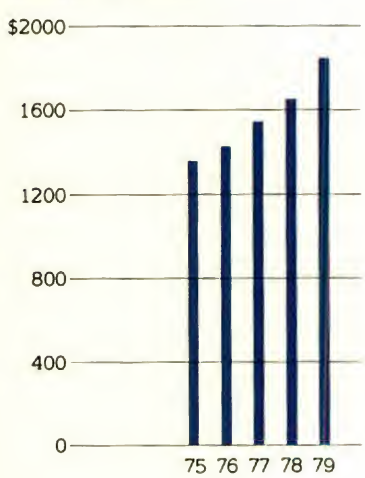
Sales

Net sales for the fiscal year were a record $1.85 billion, an increase of $184.8 million, or 11.1% over $1.67 billion for the prior year.

The following comparative summary shows the sales contribution by the operating groups of the company, in millions of dollars.

	Fiscal 1979		Fiscal 1978		%
	Sales	%	Sales	%	Change
Apparel	$ 731.3	39.5	$ 640.5	38.4	+14.2
General Retail	582.4	31.5	521.2	31.3	+11.8
Footwear	537.8	29.0	505.0	30.3	+ 6.5
	$1,851.5	100.0	$1,666.7	100.0	+11.1

Net Sales
Millions of Dollars



Each of the three operating groups registered record sales in fiscal 1979. The Apparel Group recorded the largest increase with equal improvement coming from both the women's and men's apparel business.

The Footwear Group, which includes both manufacturing and retailing, had only a modest increase in sales. The footwear retailing business had another record year, while manufacturing was affected by the discontinuance one year ago — February 28, 1978 — of the manufacture of the Florsheim women's shoes and the sale of the juvenile shoe manufacturing operation in Canada in July, 1978.

The net sales of the company, by quarter, in millions of dollars were:

	Fiscal 1979	Fiscal 1978
First quarter	$ 412.7	$ 378.9
Second quarter	486.0	437.9
Third quarter	502.2	445.3
Fourth quarter	450.6	404.6
	$1,851.5	$1,666.7

Earnings

Earnings before income taxes were a record $186.9 million for fiscal 1979, reflecting an increase of $25.3 million, or 15.7% higher than the pre-tax earnings of $161.6 million for last year.

Pre-tax earnings of each operating group of the company, before corporate expenses and interest cost, are compared in millions of dollars, as follows:

	Fiscal 1979		Fiscal 1978		%
	Amount	%	Amount	%	Change
Apparel	$ 95.6	48.4	$ 86.7	51.2	+10.2
General Retail	40.6	20.5	38.1	22.5	+ 6.5
Footwear	61.5	31.1	44.6	26.3	+38.1
	$197.7	100.0	$169.4	100.0	+16.7

Each of the three operating groups contributed record high earnings in fiscal 1979, and, as a result, our margin of profitability — pre-tax earnings before corporate expenses and interest cost to sales — continued at a high level. The Apparel Group profit margin was 13.1%, the Footwear Group was 11.4% and the General Retail Group was 7.0%.

Net earnings for the year were a record $92.6 million, an increase of 13.1% over the net earnings of $81.8 million for the previous year.

Earnings per common share were $6.37 for fiscal 1979, an increase of $0.67 per share, or 11.8% over the $5.70 per share earnings in fiscal 1978.

Net earnings and earnings per common share for each quarter are compared in the following:

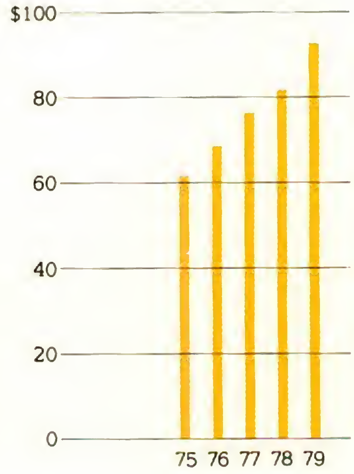
	Net Earnings (In millions)		Net Earnings Per Share	
	Fiscal 1979	Fiscal 1978	Fiscal 1979	Fiscal 1978
First quarter	$17.4	$15.9	$1.20	$1.11
Second quarter	21.5	19.0	1.47	1.32
Third quarter	26.1	23.3	1.80	1.62
Fourth quarter	27.6	23.6	1.90	1.65
	$92.6	$81.8	$6.37	$5.70

Financial Position

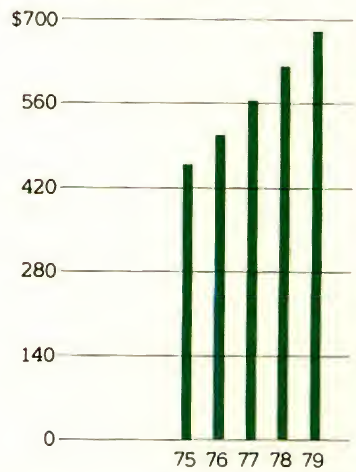
The company's strong financial position continued during the 1979 fiscal year.

- ☐ Cash and marketable security investments — short and long-term — were $105.7 million at year end, after providing our operating needs for greater inventories, accounts receivable and capital expenditures.
- ☐ Working capital, which is the excess of current assets over current liabilities, reached a new high of $537.9 million at the end of fiscal 1979 — a gain of $5.5 million over the prior year. The working capital ratio was 3.7 to 1 at February 28, 1979. During the year, $48.8 million of current assets were invested in longer term assets in order to improve our return on assets employed.
- ☐ Accounts receivable were $216.5 million at February 28, 1979 — higher by 11.0% over last year and in line with the volume increase in the fourth quarter.
- ☐ The higher inventories reflect the high costs of raw materials, retail merchandise and the acquisition of two companies during fiscal 1979 that have been included since their dates of acquisition. In general, the inventory position is very close to our budgeted level at year end.
- ☐ Long-term debt, including capitalized leases of $68.1 million, less current maturities, was $109.4 million at February 28, 1979, which is 16.0% of the stockholders' equity of the company.
- ☐ Stockholders' equity was $684.2 million at February 28, 1979 — up 10.1% from $621.5 million at the end of fiscal 1978. The return on average stockholders' investment was 14.2% for fiscal 1979. Book value per common share increased to $47.56 from $43.34 one year ago.

Net Earnings
Millions of Dollars

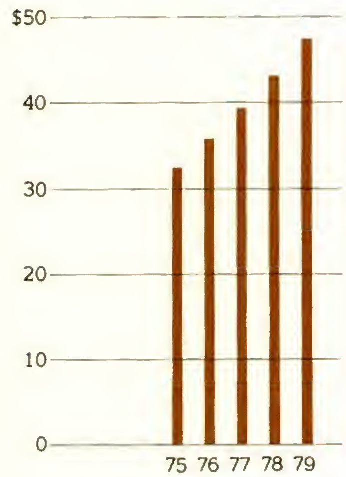


Stockholders Equity
Millions of Dollars



Fiscal 1979 in Review
(continued)

Book Value Per Share



Capital Expenditures

The company continued its program of expansion and modernization in fiscal 1979, with capital expenditures of $46.6 million, which included $16.4 million of capital leases. These expenditures were for new retail stores, modernization of manufacturing plants and equipment, and expansion of distribution facilities. The expenditures also include refurbishment of a number of existing retail locations.

Capital expenditures of company owned property for fiscal 1980 are forecast to be $32 million and will include about 100 general retail and footwear stores and departments, as well as, expanded distribution facilities at Campus Sweater and Sportswear Company, College-Town and Londontown Corporation. Depreciation expense will be approximately $23 million for fiscal 1980.

Dividends

Shareholders received $30.4 million in common stock dividends. The quarterly cash dividends paid per share were as follows:

	Fiscal 1979	Fiscal 1978
First quarter	$0.50	$0.45
Second quarter	0.50	0.45
Third quarter	0.55	0.45
Fourth quarter	0.55	0.50

The current quarterly dividend rate on common stock is $0.55 per share, or $2.20 per share, annually, and became effective with the October 15, 1978 payment.

Common Stock

There were 14,386,479 shares of common stock outstanding at February 28, 1979.

Starting in December 1978, the company began the repurchase of its common stock on the open market or by private transaction. Through February 28, 1979, 152,300 shares were purchased at a cost of $5,787,000. The Board has authorized the repurchase of up to 500,000 shares.

The common stock of INTERCO is traded on the New York Stock Exchange, and fluctuations in the high and low quoted prices for each quarter are shown in the following:

	Fiscal 1979		Fiscal 1978	
	High	Low	High	Low
First quarter	$45½	$38	$43	$36¾
Second quarter	44⅜	41⅞	41⅝	37¼
Third quarter	44¼	34¾	45⅝	38⅞
Fourth quarter	39½	34	46⅛	38¾

The closing market price of INTERCO's common stock on February 28, 1979 was $37.25 per share.

Acquisition

On July 12, 1978, the company acquired substantially all of the net assets of Alberts, Inc. for $18.3 million.

For a full description of Alberts, Inc., refer to page 4 of this report. Its operations were included in INTERCO's reporting in fiscal 1979, from the date of acquisition.

Operating Board

William B. Klinsky, President of Alberts, Inc., was appointed to the Operating Board of INTERCO on July 12, 1978.

Trademarks and Tradenames

The trademarks and tradenames of INTERCO and its subsidiaries, appearing in this Annual Report, are italicized. StormShed is a licensed trademark.

Charts

The charts, in the Fiscal 1979 in Review, have been restated to include companies acquired on a pooling of interests basis for years prior to their affiliation and the retroactive restatement of capital leases.

Consolidated Financial Statements

INTERCO INCORPORATED

Consolidated Balance Sheet
(Dollars in thousands)

ASSETS

February 28	1979	1978
Current assets:		
Cash	$ 7,116	$ 4,251
Marketable securities	61,046	109,543
Receivables, less allowances of $10,436 ($9,897 in 1978)	216,546	195,094
Inventories	439,959	379,823
Prepaid expenses and other current assets	9,880	8,584
Total current assets	734,547	697,295
Marketable investment securities	37,509	—
Property, plant and equipment:		
Land	9,546	8,440
Buildings and improvements	205,139	177,476
Machinery and equipment	143,564	135,400
	358,249	321,316
Less accumulated depreciation	150,608	140,725
Net property, plant and equipment	207,641	180,591
Other assets	23,378	21,892
	$1,003,075	$899,778

See accompanying notes to consolidated financial statements.

LIABILITIES AND STOCKHOLDERS' EQUITY

February 28	1979	1978
Current liabilities:		
Foreign bank borrowings	$ —	$ 7,998
Current maturities of long-term debt	4,024	3,986
Current maturities of capital lease obligations	3,602	3,077
Accounts payable and accrued expenses	157,244	125,385
Income taxes	31,799	24,488
Total current liabilities	196,669	164,934
Long-term debt, less current maturities	41,236	42,825
Obligations under capital leases, less current maturities	68,146	58,325
Other long-term liabilities	12,860	12,182
Stockholders' equity:		
Preferred stock, no par value, authorized 577,060 shares of first preferred and 1,000,000 shares of second preferred — issued, none	—	—
Common stock, $7.50 stated value, authorized 50,000,000 shares — issued, 14,538,779 shares in 1979 and 14,341,155 shares in 1978	109,041	107,559
Capital surplus	55,709	50,903
Retained earnings	525,201	463,050
	689,951	621,512
Less 152,300 shares of common stock in treasury, at cost	5,787	—
Total stockholders' equity	684,164	621,512
	$1,003,075	$899,778

Consolidated Statement of Earnings
(Dollars in thousands except per share data)

Years Ended February 28	1979	1978
Income:		
Net sales	$1,851,458	$1,666,657
Other income, net	19,503	16,625
	1,870,961	1,683,282
Costs and expenses:		
Cost of sales	1,266,618	1,158,387
Selling, general and administrative expenses	407,904	354,918
Interest expense	9,570	8,398
	1,684,092	1,521,703
Earnings before income taxes	186,869	161,579
Income taxes	94,293	79,745
Net earnings	$ 92,576	$ 81,834
Earnings per share	$6.37	$5.70

See accompanying notes to consolidated financial statements.

Consolidated Statement of Changes in Financial Position

(Dollars in thousands)

Years Ended February 28	1979	1978
Working capital provided by:		
Net earnings	$ 92,576	$ 81,834
Items not affecting working capital:		
Depreciation	21,850	20,241
Other, net	1,712	636
Operations	116,138	102,711
Disposal of property, plant and equipment	3,677	2,545
Issuance of common stock for acquisition	5,554	—
Exercise of stock options	727	874
Issuance of common stock for restricted stock plan	7	117
Working capital of purchased companies	18,025	—
Additions to long-term debt	2,970	673
Additions to capital lease obligations	16,427	9,227
Issuance of common stock for conversion of preferred stock — contra below	—	13,613
Other, net	207	—
	163,732	129,760
Working capital used for:		
Cash dividends	30,425	26,491
Additions to property, plant and equipment:		
Company owned property	30,173	19,980
Leased property	16,427	9,227
Marketable investment securities	36,509	—
Purchase of companies	24,003	—
Additional payment — purchased companies	2,887	—
Reduction of long-term debt	4,625	3,986
Reduction of capital lease obligations	7,379	4,958
Purchase of treasury shares	5,787	—
Conversion of preferred stock — contra above	—	13,613
Other, net	—	300
	158,215	78,555
Increase in working capital	$ 5,517	$ 51,205
Working capital increased (decreased) by:		
Cash and marketable securities	$ (45,632)	$ 19,005
Receivables	21,452	5,151
Inventories	60,136	51,199
Prepaid expenses and other current assets	1,296	(891)
Foreign bank borrowings	7,998	(562)
Current maturities of long-term debt	(38)	(123)
Current maturities of capital lease obligations	(525)	(141)
Accounts payable and accrued expenses	(31,859)	(18,306)
Income taxes	(7,311)	(4,127)
	$ 5,517	$ 51,205

See accompanying notes to consolidated financial statements.

Consolidated Statement of Stockholders' Equity

(Dollars in thousands except per share data)

	Preferred Stock	Common Stock Issued	Common Stock In Treasury	Capital Surplus	Retained Earnings	Total
Balance February 28, 1977:						
As previously reported . . .	$ 13,613	$104,148	$ —	$ 39,710	$407,707	$565,178
Net earnings					81,834	81,834
Cash dividends:						
Preferred stock					(1)	(1)
Common stock — $1.85 per share					(26,490)	(26,490)
Conversion of preferred stock:						
Series C — 136,131 shares	(13,613)	3,118		10,495		
Exercise of stock options:						
Common — 36,214 shares		272		602		874
Restricted stock plan:						
Common — 2,839 shares		21		96		117
Balance February 28, 1978	—	107,559	—	50,903	463,050	621,512
Net earnings					92,576	92,576
Cash dividends:						
Common stock — $2.10 per share					(30,425)	(30,425)
Issuance of 166,635 common shares for acquisition		1,250		4,304		5,554
Exercise of stock options:						
Common — 30,790 shares		231		496		727
Restricted stock plan:						
Common — 199 shares		1		6		7
Purchase of 152,300 treasury shares			(5,787)			(5,787)
Balance February 28, 1979	$ —	$109,041	$ (5,787)	$ 55,709	$525,201	$684,164

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(Dollars in thousands except per share data)

February 28, 1979 and 1978

1. **Significant Accounting Policies** — The company and its subsidiaries employ generally accepted accounting principles on a consistent basis to present fairly their consolidated financial position, results of operations, and changes in financial position. The company's fiscal year ends on the last day of February. The major accounting policies of the company are set forth below.

Principles of Consolidation — The consolidated financial statements include the accounts of the company and all domestic and foreign subsidiaries, the majority of which are wholly owned. All material intercompany transactions have been eliminated in consolidation.

Marketable Securities — Marketable securities, consisting principally of commercial paper, are stated at cost which approximates market.

Inventories — Inventories are stated at the lower of cost (first-in, first-out) or market, except for most footwear manufacturing inventories which are priced on the "last-in, first-out" method of inventory valuation.

Marketable Investment Securities — Marketable investment securities consist of bonds and stocks held for long-term investment. Dividend and interest income are accrued as earned.

Marketable equity securities are carried at the lower of aggregate cost or market of the portfolio. Other marketable investment securities are carried at cost as there has been no permanent impairment in the market value of the portfolio.

Property, Plant and Equipment — Property, plant and equipment is stated at cost. Facilities and equipment leased under capital leases are included in property, plant and equipment with the corresponding principal payments carried in obligations under capital leases. Expenditures for improvements are capitalized. Normal repairs and maintenance are expensed as incurred. When properties are retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the accounts and gains or losses on the dispositions are reflected in operations.

Depreciation — For financial reporting purposes, the company employs both accelerated and straight-line methods of computing depreciation. Amortization of assets recorded under capital leases is included in depreciation expense. Approximately 85% and 83% of depreciation expense was computed on the straight-line method in fiscal 1979 and fiscal 1978, respectively.

Excess of Investment Over Equity in Subsidiaries — Cost in excess of net assets of companies acquired is being amortized on a straight-line basis, generally over 40 years.

Start-Up Expenses — Start-up expenses of new facilities are charged to operations in the year incurred.

Pension Plans — The company's policy with respect to pension plans is to fund pension costs accrued, and to amortize prior service costs, generally over 30 years.

Income Taxes — Investment tax credits are reflected as a reduction of Federal income taxes in the period in which qualified property is placed in service. It is the company's intent that the undistributed earnings of subsidiaries will either be reinvested in the subsidiaries or distributed tax-free to the parent company. Accordingly, no provision has been made for income taxes on such undistributed earnings.

Notes to Consolidated Financial Statements
(continued)

2. **Business Combinations** — On March 31, 1978, the company acquired all the outstanding stock of International Hat Company in exchange for 166,635 shares of the company's common stock. Additional shares may be issued in 1981 based upon the profit performance of the acquired company.

On July 12, 1978, the company acquired substantially all of the net assets of Alberts, Inc. for $18,347 in cash.

These transactions were accounted for as purchases and the results of operations are included from the dates of acquisition. The results of operations of the purchased companies for fiscal 1978 and prior to acquisition in fiscal 1979 are not material to the consolidated statement of earnings.

3. **Inventories** — Inventories are summarized as follows:

	1979	1978
Retail merchandise	$218,130	$195,086
Finished products	104,658	81,303
Work in process	35,194	30,710
Raw materials	81,977	72,724
	$439,959	$379,823

All the major categories of inventory, except retail merchandise, include certain items priced on the "last-in, first-out" method. Had the "first-in, first-out" method been applied to all inventories, they would have been stated at approximately $469,290 and $405,749 at February 28, 1979 and 1978, respectively.

4. **Marketable Investment Securities** — Marketable investment securities consist of the following:

	1979
Equity securities, at cost	$ 3,506
Bonds, at cost	34,003
	$37,509

Marketable investment securities earned $125 in dividend income and $2,212 in interest income in fiscal 1979.

The portfolio of equity securities included gross unrealized gains and losses of $142 and $141, respectively, at February 28, 1979. There were no realized gains or losses during the year.

5. **Long-Term Debt** —Long-term debt consists of the following:

	1979	1978
4⅝% promissory installment notes, payable $1,875 annually, 1979-1989, and balance in 1990	$33,125	$35,000
6% promissory installment notes, payable $1,250 in 1979 and balance in 1980	3,375	4,625
Foreign mortgages payable with interest rates of 10¾%, due through 1985	2,970	569
Other debt at 1% to 9½% interest rates, payable in varying amounts through 1991	5,790	6,617
	45,260	46,811
Less current maturities	4,024	3,986
	$41,236	$42,825

Maturities of long-term debt are $4,024, $4,824, $2,599, $2,506 and $3,310 for fiscal years 1980 through 1984, respectively.

The 4⅝% note agreement restricts, among other things, retained earnings of $43,810 as to payment of cash dividends on capital stock and the purchase, redemption or retirement of capital stock.

6. **Obligations Under Capital Leases** — The amount capitalized under capital leases is the present value of the minimum lease payments or the fair value of the leased properties at the beginning of the respective lease terms. Generally, interest rates applicable to capital leases range between 4¾% and 9½% for leased facilities and between 7½% and 16% for leased equipment. Obligations under capital leases amounted to $71,748 and $61,402 at February 28, 1979 and 1978, respectively. Maturities of these obligations are $3,602, $3,693, $3,464, $3,668 and $3,457 for fiscal years 1980 through 1984, respectively.

7. **Common Stock** — Shares of common stock were reserved for the following purposes at February 28, 1979:

	Number of Shares
Common stock options:	
Granted	394,283
Available for grant	32,876
Restricted stock plan of pooled company	5,390
Contingent shares based on profit performance	160,000
	592,549

Under the company's stock option plans, certain key employees may be granted qualified or non-qualified options to purchase shares of common stock. Qualified options granted under the plans may not be less than 100% of the fair market value of the common stock on the date an option is granted, and non-qualified options at not less than 85%. All options which have been granted, qualified and non-qualified, were at 100% of fair market value on the date of grant, and are exercisable on varying or staggered dates not less than one year after the date of grant. Qualified options expire five years after the date of grant or on May 20, 1981, whichever first occurs, and non-qualified options expire ten years after the date of grant.

Changes in options granted are summarized as follows:

	1979		1978	
	Shares	Average Price	Shares	Average Price
Beginning of year	144,439	$28.90	136,978	$23.47
Options granted	287,574	35.09	48,964	38.55
Options exercised	(30,790)	20.98	(36,214)	20.69
Options cancelled	(6,940)	34.42	(5,289)	33.79
End of year	394,283	33.94	144,439	28.90
Exercisable at end of year	61,992		56,060	

8. **Income Taxes** — Income tax expense is composed of the following:

	1979	1978
Current:		
Federal	$82,823	$67,947
State and city	9,087	8,257
Foreign (principally Canadian)	2,757	1,289
	94,667	77,493
Deferred	(374)	2,252
	$94,293	$79,745
Investment tax credits	$ 1,266	$ 1,244

The following table reconciles the differences between the company's effective income tax rate and the Federal corporate statutory rate:

	1979	1978
Federal corporate statutory rate	47.7%	48.0%
State and local income taxes, net of Federal tax benefit	2.6	2.7
Investment tax credits	(.7)	(.8)
Foreign taxes, including foreign currency translation effects	.4	(.1)
Other	.5	(.4)
Effective income tax rate	50.5%	49.4%

Certain items are recognized for income tax purposes in years other than those in which they are reported in the consolidated financial statements. Future Federal income tax benefits at February 28, 1979 and 1978 are included in the accompanying consolidated balance sheet as follows:

	1979	1978
Prepaid expenses and other current assets	$4,207	$2,623
Other assets	2,388	3,598
	$6,595	$6,221

The Federal income tax returns of the company and its major subsidiaries have been examined through fiscal year ended February 29, 1976.

9. **Pension Plans** — The company and its subsidiaries have pension plans covering substantially all employees. Total pension expense was $14,300 and $13,500 in fiscal 1979 and fiscal 1978, respectively. As of the most recent valuation dates, the actuarially computed value of vested benefits under defined benefit pension plans exceeded assets of the plans by approximately $55,400, and the unfunded past service cost under the pension plans of the company and its subsidiaries aggregated approximately $74,000.

10. **Lease Commitments** — Substantially all of the company's retail outlets and certain other real properties and equipment are operated under lease agreements expiring at various dates through the year 2003. Leases covering retail outlets and equipment generally require, in addition to stated minimums, contingent rentals based on retail sales and equipment usage. Generally, the leases provide for renewal for various periods at stipulated rates.

Assets recorded under capital leases are as follows:

	1979	1978
Land	$ 653	$ 699
Buildings	73,760	62,206
Machinery and equipment	7,799	8,062
	82,212	70,967
Accumulated depreciation	20,603	18,339
	$61,609	$52,628

Future minimum lease payments under capital leases at February 28, 1979, aggregate $143,497, of which $71,748 is included in obligations under capital leases and current maturities, $57,965 represents interest and the balance represents other costs of the leases including taxes, insurance and maintenance. Annual payments under capital leases are $10,221, $10,321, $9,746, $9,609 and $9,047 for fiscal years 1980 through 1984, respectively.

Lease costs under operating leases and contingent costs of capital leases are considered rental expense. Total rental expense was as follows:

	1979	1978
Basic rentals under operating leases	$27,964	$26,672
Contingent rentals	20,701	16,994
	48,665	43,666
Less sublease rentals	1,273	1,213
	$47,392	$42,453

Included in rental expense above is the cost of services provided by lessors of leased retail departments, estimated to aggregate $8,000 and $7,200 in fiscal 1979 and fiscal 1978, respectively.

Future minimum lease payments under operating leases at February 28, 1979, aggregate $199,278. Annual payments under operating leases are $26,540, $24,252, $21,904, $19,959 and $17,793 for fiscal years 1980 through 1984, respectively.

The minimum rental commitments have been reduced by rentals from subleases. These subleases, expiring at various dates to 1993, provide for aggregate minimum rentals of approximately $3,556.

The company has also guaranteed leases of certain retail outlets of customers which at February 28, 1979, aggregated approximately $1,600 based on minimum rentals.

Notes to Consolidated Financial Statements
(continued)

11. **Litigation** — The company is a defendant and may become a defendant in a number of pending or threatened legal proceedings in the ordinary course of business. In the opinion of management, the ultimate liability, if any, of the company from all such proceedings will not have a material adverse effect upon the consolidated financial position or results of operations.

    The Federal Trade Commission has completed its investigation into the marketing and distribution methods of certain of the company's apparel and footwear manufacturing operations and has accepted a Consent Agreement containing a Consent Order to Cease and Desist. Various State Attorneys General are currently investigating the same footwear marketing and distribution methods for possible violations of their respective state's antitrust laws. Although the company has no indication as to what action, if any, these states may take at the conclusion of their investigations, management is of the opinion that the ultimate liability, if any, resulting from any action will not have a material adverse effect upon its consolidated financial position or results of operations.

12. **Earnings Per Share of Common Stock** — Fully diluted earnings per share are based on the weighted average number of shares of common stock and common stock equivalents outstanding during the years, plus those common shares which would have been issued if conversion of all preferred stock had taken place at the beginning of each year. Common stock options, the exercise of which would result in dilution of earnings per share, are considered common stock equivalents.

    Primary earnings per share are based on those shares included in the fully diluted earnings per share calculations, except that conversion of preferred stock has not been assumed. Net earnings for this computation are reduced by preferred stock dividend requirements.

    In fiscal 1979 and fiscal 1978, fully diluted earnings per share do not differ from primary earnings per share.

13. **Business Segment Information** — The company's three business segments are Apparel Manufacturing, General Retail Merchandising, and Footwear Manufacturing and Retailing. Specific information relating to the operating companies and their products which comprise each segment is included on the inside front cover and on pages 6 through 19 of the Annual Report.

Summarized financial information by business segments is as follows:

	1979	1978
Sales to unaffiliated customers:		
Apparel	$ 731,259	$ 640,487
Retail	582,441	521,178
Footwear	537,758	504,992
Total	$1,851,458	$1,666,657
Operating profit:		
Apparel	$ 95,585	$ 86,745
Retail	40,581	38,096
Footwear	61,520	44,552
	197,686	169,393
Corporate expenses and interest cost	(10,817)	(7,814)
Earnings before income taxes	$ 186,869	$ 161,579
Identifiable assets at year end:		
Apparel	$ 357,003	$ 295,518
Retail	286,528	238,569
Footwear	268,187	258,572
	911,718	792,659
Corporate assets	91,357	107,119
Total	$1,003,075	$ 899,778
Depreciation expense:		
Apparel	$ 6,494	$ 6,287
Retail	8,467	7,267
Footwear	6,325	6,209
Capital expenditures:		
Apparel	$ 11,198	$ 8,704
Retail	27,146	14,140
Footwear	7,442	5,959

Sales between business segments, which account for less than 1% of the sales of any one business segment, are considered immaterial and are netted against the sales of the respective segment. Operating profit of the

business segment is its sales less all operating expenses. Minority interests in certain subsidiaries are immaterial and have been included in corporate expenses and interest cost.

Identifiable assets of a business segment are those assets that are used by that segment in its operations. Corporate assets consist primarily of cash, marketable securities and marketable investment securities.

Substantially all of the company's sales are made to unaffiliated customers and no one customer accounted for 10% of the consolidated sales. Foreign operations are not material in relation to the consolidated financial position or results of operations.

14. **Quarterly Financial Information (Unaudited)** — In the opinion of management,the following quarterly information includes all adjustments necessary for a fair presentation:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Fiscal 1979				
Net sales	$412,651	$485,964	$502,200	$450,643
Gross profit	125,498	144,599	155,678	159,065
Earnings before income taxes	34,699	43,352	52,594	56,224
Net earnings	$ 17,374	$ 21,476	$ 26,136	$ 27,590
Earnings per share	$1.20	$1.47	$1.80	$1.90
Fiscal 1978				
Net sales	$378,882	$437,867	$445,341	$404,567
Gross profit	114,025	124,959	134,817	134,469
Earnings before income taxes	31,943	38,354	45,718	45,564
Net earnings	$ 15,948	$ 18,984	$ 23,284	$ 23,618
Earnings per share	$1.11	$1.32	$1.62	$1.65

15. **Replacement Cost Data (Unaudited)** — The Securities and Exchange Commission requires many large companies to report certain information relating to replacement cost of inventories and fixed assets, and the impact of these costs upon depreciation and cost of sales.

In the normal course of business, the company has been able and will continue to replace its productive capacity in an orderly manner. Historically, the company has been able to compensate for cost increases through increases in productivity and selling prices in order to maintain an approximately constant gross profit percentage of sales.

Due to inflation and the cost of technological improvements, the replacement of plant and equipment with assets having equivalent productive capacity has usually required a substantially greater capital investment than was required to purchase the assets which were being replaced. The additional capital investment principally reflects the cumulative impact of inflation on the long-lived nature of these assets.

The company's annual report on Form 10-K (a copy of which is available upon request) will contain more specific information with respect to replacement cost of inventories and productive capacity (buildings, machinery and equipment), and the approximate effect which replacement cost would have had on the computation of cost of sales and depreciation expense for fiscal 1979 and fiscal 1978.

PEAT, MARWICK, MITCHELL & CO.
Certified Public Accountants
720 Olive Street
St. Louis, Missouri

THE BOARD OF DIRECTORS
AND STOCKHOLDERS
INTERCO INCORPORATED:

We have examined the consolidated balance sheets of INTERCO INCORPORATED and subsidiaries as of February 28, 1979 and 1978 and the related consolidated statements of earnings, stockholders' equity, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of INTERCO INCORPORATED and subsidiaries at February 28, 1979 and 1978 and the results of their operations, and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Peat, Marwick, Mitchell & Co.

April 11, 1979

Five Year Consolidated Financial Review

(Dollars in thousands except per share data)

	FISCAL YEARS ENDED				
	1979	1978	1977	1976	1975
FOR THE YEAR					
Summary of operations:					
Net sales	**$1,851,458**	$1,666,657	$1,566,432	$1,424,252	$1,373,223
Cost of sales	**1,266,618**	1,158,387	1,094,826	992,754	963,801
Interest expense	**9,570**	8,398	7,766	6,901	8,743
Earnings before income taxes	**186,869**	161,579	149,392	135,785	121,087
As a percent of sales	**10.1%**	9.7%	9.5%	9.5%	8.8%
Income taxes	**94,293**	79,745	73,122	67,212	59,853
Net earnings	**92,576**	81,834	76,270	68,573	61,234
As a percent of sales	**5.0%**	4.9%	4.9%	4.8%	4.5%
Earnings applicable to common stock	**92,576**	81,834	75,541	67,799	60,386
Per share of common stock:					
Fully diluted earnings	**$6.37**	$5.70	$5.32	$4.81	$4.31
Dividends	**$2.10**	$1.85	$1.62½	$1.47½	$1.43½
Average common and common equivalent shares outstanding (in thousands)	**14,535**	14,365	14,324	14,268	14,207
Cash dividends paid:					
On common stock	**$30,425**	$26,490	$21,998	$18,150	$17,270
On preferred stock	**$ —**	$ 1	$ 729	$ 791	$ 850
AT YEAR END					
Working capital	**$ 537,878**	$532,361	$481,156	$437,736	$395,615
Property, plant and equipment, net	**207,641**	180,591	174,170	156,047	149,365
Capital expenditures:					
Company owned property	**30,173**	19,980	26,006	21,698	21,158
Capitalized leased property	**16,427**	9,227	10,208	3,486	5,513
Total assets	**1,003,075**	899,778	819,360	755,387	673,097
Long-term debt	**41,236**	42,825	46,138	47,443	50,576
Obligations under capital leases	**68,146**	58,325	54,056	46,069	44,825
Stockholders' equity	**684,164**	621,512	565,178	508,328	456,995
Book value per common share	**$47.56**	$43.34	$39.72	$36.00	$32.73

The above figures have been restated to include pooled companies for years prior to their acquisition and for the retroactive restatement of capital leases.

Management's Discussion and Analysis of Operations

Net Sales — Sales for fiscal 1979 again established a new record with an increase of 11.1% over fiscal 1978 compared to a 6.4% increase for fiscal 1978 over fiscal 1977.

Each major operating group, Apparel Manufacturing, General Retail Merchandising, and Footwear Manufacturing and Retailing registered sales increases of 14.2%, 11.8% and 6.5%, respectively, as compared to last year's increases of 11.2%, 4.5% and 2.7%.

In the Apparel Manufacturing Group, the strong showings in fiscal 1979 and fiscal 1978 were attributable to the increased demand for outerwear and other heavier clothing brought on by the past three severe winters, and the continued acceptance of the women's apparel lines with further penetration into new markets during these years.

Gains in the General Retail Merchandising Group were generated through new stores, the maturation of existing stores, and a trend by the customers of the home improvement and do-it-yourself centers to invest in energy-saving products and materials.

In the Footwear Manufacturing and Retailing Group, retail sales continued strong throughout the year; however, in the manufacturing operation, only modest sales gains were recorded. Unit sales decreased because of the discontinuance of the manufacture of women's shoes at Florsheim at February 28, 1978, and the sale of the juvenile shoe manufacturing operation in Canada in July 1978. Increased selling prices during the year, the result of higher costs of raw materials, primarily hides and leather, provided the modest sales gain.

Cost of Sales and Operating Expenses — Cost of sales and operating expenses combined were 90.4% of sales in fiscal 1979 compared to 90.8% in fiscal 1978.

Cost of sales, as a percent of sales, was 68.4% and 69.5% in fiscal 1979 and fiscal 1978, respectively. On a comparative basis, after adjusting for the acquired companies accounted for as a purchase, the increase in cost of sales was 6.1% for fiscal 1979 and 5.8% for fiscal 1978. In fiscal 1979, the Footwear group had improved gross profit margins as a result of a strengthening in the domestic footwear market, the elimination of the women's shoe manufacturing operation at Florsheim, and the sale of the juvenile shoe manufacturing business in Canada.

Operating expenses, as a percent of sales, were 22.0% in fiscal 1979 and 21.3% in fiscal 1978. The increase in fiscal 1979 was 10.6%, after adjusting for the purchased companies, compared to a 7.4% increase last year. The increase for fiscal 1979, as a percent of sales, and the percentage increase over the prior year, after accounting for the sales increase, were principally caused by the production curtailment of jeans during the year, and the increased cost of doing business in the General Retail Merchandising Group.

Interest Expense — Interest expense increased by $1,172,000 or 14.0% in fiscal 1979, as compared to an increase of $632,000, or 8.1% in fiscal 1978. The increase for fiscal 1979 was the result of increased domestic and foreign short-term borrowings during the year and interest on capitalized leases.

Earnings Before Income Taxes — Earnings before income taxes increased by 15.7% in fiscal 1979 as compared to an 8.2% increase in fiscal 1978. The increase in fiscal 1979 reflected improvement in each of the three operating groups, with the Footwear Group showing substantial improvement as noted in the cost of sales analysis.

Income Taxes — Income taxes for fiscal 1979 increased by 18.2% with an effective tax rate of 50.5% as compared to an increase last year of 9.1% and an effective tax rate of 49.4%. After giving effect to the slightly higher effective rate for fiscal 1979, the increase is in line with the increase in earnings before taxes.

Earnings Per Share — Earnings per share increased by 11.8% and 7.1% in fiscal 1979 and 1978, respectively. The percentage increase, which is less than the earnings increase, is the result of a larger number of average shares outstanding in fiscal 1979 over fiscal 1978. The treasury stock acquisition program, which began late in fiscal 1979, did not affect earnings per share.

Directors, Officers and the Operating Board

Board of Directors

RONALD L. AYLWARD
Vice President and General Counsel of the Company

ZANE E. BARNES
President and Chief Executive Officer of Southwestern Bell Telephone Company

MAURICE R. CHAMBERS
Chairman of the Executive Committee of the Company

STANLEY M. COHEN
President, Central Hardware Company

WILLIAM L. EDWARDS, JR.
Chairman of the Board and Chief Executive Officer of the Company

EDWIN S. JONES
Chairman of the Executive Committee, First Union Bancorporation and First National Bank in St. Louis

DONALD E. LASATER
Chairman of the Board, Mercantile Bancorporation, Inc. and Mercantile Trust Company National Association

JONATHAN P. MYERS
President, Londontown Corporation

THOMAS H. O'LEARY
President, Missouri Pacific Corporation

NORFLEET H. RAND
Retired

JOHN K. RIEDY
President and Chief Operating Officer of the Company

CHARLES J. ROTHSCHILD, JR.
President, Campus Sweater & Sportswear Company

HARVEY SALIGMAN
President, Queen Casuals, Inc.

Executive Committee

Maurice R. Chambers, Chairman
Ronald L. Aylward
William L. Edwards, Jr.
Norfleet H. Rand
John K. Riedy

Audit Committee

Donald E. Lasater, Chairman
Zane E. Barnes
Edwin S. Jones
Thomas H. O'Leary

Corporate Officers

WILLIAM L. EDWARDS, JR.
Chairman of the Board and Chief Executive Officer

JOHN K. RIEDY
President and Chief Operating Officer

STANLEY M. COHEN
Vice President

RONALD L. AYLWARD
Vice President and General Counsel

GERALD B. HIRSCH
Vice President

JONATHAN P. MYERS
Vice President

J. CARL POWERS
Vice President

CHARLES J. ROTHSCHILD, JR.
Vice President

HARVEY SALIGMAN
Vice President

DUANE A. PATTERSON
Secretary

†EDWARD P. GRACE
Treasurer

STANLEY F. HUCK
Controller

KEITH E. MATTERN
Assistant Secretary

JAMES K. PENDLETON
Assistant Secretary

WILLIAM R. WITHROW
Assistant Treasurer

RUSSELL L. BAUMANN
Assistant Controller

WILFRED G. MORICE
Assistant Controller

†Deceased April 13, 1979

Executive Compensation and Stock Option Committee

Maurice R. Chambers, Chairman
Zane E. Barnes
Edwin S. Jones
Donald E. Lasater
Thomas H. O'Leary
Norfleet H. Rand

Operating Board

WILLIAM L. EDWARDS, JR.
Chairman of the Board and Chief Executive Officer of the Company

JOHN K. RIEDY
President and Chief Operating Officer of the Company

RONALD L. AYLWARD
Vice President and General Counsel of the Company

LIONEL BAXTER
President, Big Yank Corporation

STANLEY M. COHEN
President, Central Hardware Company

WILLIAM B. COWDEN
Chairman of the Board, Cowden Manufacturing Company

BARRY S. FINE
President, Fine's Men's Shops, Incorporated and Standard Sportswear

JEAN S. GOODSON
President, International Hat Company

GERALD B. HIRSCH
President, P. N. Hirsch & Company

WILLIAM B. KLINSKY
President, Alberts, Inc.

STANLEY MATZKIN
President, Devon Apparel

JONATHAN P. MYERS
President, Londontown Corporation

MYRON C. PETERSON
Chairman of the Board and President, Sky City Stores, Inc.

J. CARL POWERS
President, International Shoe Company

HARVEY ROTHENBERG
Chairman of the Board, Stuffed Shirt/Stuffed Jeans, Inc.

CHARLES J. ROTHSCHILD, JR.
President, Campus Sweater & Sportswear Company

HARVEY SALIGMAN
President, Queen Casuals, Inc.

ARTHUR SIBLEY
President, College-Town

JOHN WEIL
President, Eagle Family Discount Stores, Inc.

Principal Companies of INTERCO

Apparel Manufacturing Group

BIG YANK CORPORATION
New York, New York

THE BILTWELL COMPANY, INC.
St. Louis, Missouri

CAMPUS SWEATER & SPORTSWEAR COMPANY
Paramus, New Jersey

COLLEGE-TOWN
Braintree, Massachusetts

COWDEN MANUFACTURING COMPANY
Lexington, Kentucky

DEVON APPAREL
Philadelphia, Pennsylvania

INTERNATIONAL HAT COMPANY
St. Louis, Missouri

LONDONTOWN CORPORATION
Eldersburg, Maryland

QUEEN CASUALS, INC.
Philadelphia, Pennsylvania

SIDNEY GOULD CO., LTD.
Garden City Park, New York

STUFFED SHIRT/ STUFFED JEANS, INC.
New York, New York

General Retail Merchandising Group

ALBERTS, INC.
Detroit, Michigan

CENTRAL HARDWARE COMPANY
St. Louis, Missouri

EAGLE FAMILY DISCOUNT STORES, INC.
Miami, Florida

FINE'S MEN'S SHOPS, INCORPORATED
Norfolk, Virginia

GOLDE'S DEPARTMENT STORES, INC.
St. Louis, Missouri

P. N. HIRSCH & COMPANY
St. Louis, Missouri

SKY CITY STORES, INC.
Asheville, North Carolina

STANDARD SPORTSWEAR
Pittsburgh, Pennsylvania

UNITED SHIRT DISTRIBUTORS, INC.
Detroit, Michigan

Footwear Manufacturing and Retailing Group

THE FLORSHEIM SHOE COMPANY
Chicago, Illinois

INTERNATIONAL SHOE COMPANY
St. Louis, Missouri

SENACK SHOES, INC.
St. Louis, Missouri

FLORSHEIM INC
Cambridge, Ontario, Canada

Transfer Agents

Manufacturers Hanover Trust Company
New York, New York
(212) 623-3157

Mercantile Trust Company National Association
St. Louis, Missouri
(314) 425-2755

Registrars

Morgan Guaranty Trust Company
New York, New York
(212) 483-2323

St. Louis Union Trust Company
St. Louis, Missouri
(314) 231-9300

Dividend Disbursing Agent

Mercantile Trust Company National Association
St. Louis, Missouri
(314) 425-2755

Independent Accountants

Peat, Marwick, Mitchell & Co.
St. Louis, Missouri

Exchange Listings

Symbol	Listed
ISS	New York Stock Exchange
ISS	Midwest Stock Exchange

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